Executive summary

The present actuarial review of the National Insurance Board of St. Lucia as of 30 June 1996 has highlighted the need to address the expected long-term actuarial imbalance of the NIB. It provides a basis for the decision-making process of the NIB and the Government for reform measures which would ensure the long-term financial viability of the NIB. The key decisions concern the level of contributions that can be afforded by the insured population and the level of benefit protection that can be consistently offered.

This study has shown that the NIB has not yet reached its ultimate mature state when it will enjoy a relatively stable demographic and financial development around the middle of the next century. The NIB has been in existence only for 17 years which means that only a few generations of insured persons have reached the pensionable age of 60 with a past contributory record of more than 10 years entitling them to an old-age pension. In the future, it is anticipated that the number of new old-age pensioners will significantly increase at a rate much faster than that of the number of active insured persons from whom contribution income will be collected. At the same time, the new generations of old-age pensioners will receive higher pensions than those of the present pensioners because they will have accumulated more contribution credits since the inception of the NIB. This means that the NIB cannot expect to continue enjoying in the future a situation under which its contribution income far exceeds its benefit expenditure as at present.

Based on a comprehensive macro-economic and labour market framework and assuming that all NIB benefits will be adjusted in line with projected wage developments, the actuarial projections for the NIB under the present benefit and contribution conditions (status quo provision) show that it will start incurring annual deficits, i.e. annual revenues will be lower than annual expenditures, within the next 30 years. At that point in time, the NIB will have to begin selling its reserve assets in order to meet its annual benefit obligations. The results show that the reserve will be completely depleted after approximately 10 years once annual deficits begin to emerge. The decrease of the reserve will be dramatic. Despite the efficient administration of the NIB since its inception in 1979, the NIB benefit provisions can only be sustained in the long-term if the contribution rate is increased to the ultimate pay-as-you-go cost rate level which is close to 25 per cent of insurable earnings as of the middle of the next century. This is considered a normal cost level for a mature social insurance scheme providing a level of benefit protection similar to the one under the NIB.

In macro-economic terms, the NIB benefit expenditure presently represents a low GDP share of 1.05 per cent which is expected to increase to a GDP share of 9.17 per cent by year 2050. Such an ultimate level of spending is still considered to be at the lower end of the range of present expenditure in OECD countries but close to the present level of spending in the United States of America. In short, the development of the NIB will undergo a perfectly normal process of maturing over the next five decades, given its present provisions are maintained.

In light of the present high funding ratio of the NIB equal to 20, i.e. its reserve fund being equivalent to 20 times the current level of its annual benefit outgo, which is however expected to rapidly decrease in the future as the amount of pensions will significantly increase each year, the ILO recommends that the NIB increases its future contribution rate according to a pre-determined schedule that will ensure that by the end of the projection period, in 2050, the year-end reserve fund

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1 Under a no adjustment/indexation scenario, the financial results would have appeared significantly better while benefits would be implicitly assumed to lose their purchasing power - a difficult political situation. This possibility has thus not been retained as this would imply a derogation from the original social insurance principles adopted by the NIB to provide adequate protection to pensioners. This explains why this actuarial review has assumed that benefits in payment and minimum pensions will increase in line with wages. Sensitivity tests however are provided in the Supplementary Report to show what would happen if no indexation had been assumed.
of the NIB will be equal to at least 5 times its annual benefit outgo, i.e. a funding ratio of 5. It must be noted that this funding ratio should be expected to further decrease after year 2050 until the NIB will be fully mature. In particular, given the present benefit provisions are maintained, it is proposed that the total contribution rate be increased to 11 per cent of insurable earnings as of year 2000 and that it be gradually increased to 20 per cent by year 2030 and maintained at that level until year 2050. This means that, over the period to 2050, the maintenance of the reserve and the use of the investment income to co-finance benefit obligations can keep the contribution rate in the later years of the projection period at a level which is 5 percentage points lower than the expected pay-as-you-go cost rate. Further minor increases of the contribution rate cannot be excluded as the scheme will fully mature sometime after year 2050. Future actuarial reviews should confirm the required level of the contribution rate. Such a recommendation to use a partial funding approach necessitates a concomitant investment performance of the NIB that is efficient and productive. Alternatively, the ILO recommends the revision and modification of the NIB benefit objectives in order to reduce its future financial burden and to adjust it in line with the financial capacities of its contributors. Such reform measures must be implemented at an early stage because of the long period of time required before they can reach their full impact on the overall expenditure level. As a proposal for its discussions, the ILO suggests to the NIB to gradually increase the minimum contributory requirement for an old-age pension from its present level of 10 years up to 15 years by year 2012. At the same time, it is recommended that the pensionable age be increased gradually up to age 65. Such reform measures should be studied by the NIB while bearing in mind its fundamental goals such as the target length of an average career and income replacement objectives at retirement. It should also take account of the possible impact of reforms on the labour market. The ILO remains at the disposal of the NIB for the costing of specific reform measures. Concerning the accounting system of the NIB, it is recommended that separate accounts and reserves be maintained for the different benefits branches and its administrative expenses. The contribution rate allocated to short-term benefits and employment injury benefits should be assessed on a pay-as-you-go basis - in light of the observed low take-up rates for pensions provided to victims of employment injuries - allowing a small contingency reserve, which means that necessary adjustments to the total contribution rate should be introduced when the present allocation is insufficient to meet the current expenditure. The present recommended contribution rate is of 0.9 per cent of insurable earnings. The long-term benefits branch should be initially allocated a 7 per cent contribution rate which should not be affected in the future by variations in cost of the short-term and employment injury benefits branches. The NIB cannot continue to adjust the allocations of its contribution income to the separate benefits branches by simply readjusting the current allocation within the limit of the present 10 per cent total contribution rate. It is of utmost importance that it accumulates a reserve fund for its long-term benefits branch in an orderly manner and on the basis of its long-term financial goal. The NIB should not be under pressure to allow a misuse of its reserve as it will be needed in future to pay its growing benefit obligations. The ILO strongly recommends a clarification of the purpose, objectives and legal status of the so-called Special Fund to which an arbitrarily set contribution rate of 2 per cent of insurable earnings is assigned. A decision must also be taken with respect to its administration under the NIB. A contradiction is observed as the 2% Special Fund is used for the purpose of reimbursing the Government for health expenses incurred by the NIB insured persons who pay at the same time personal income taxes that serve to finance the State general revenues. The projections under this review have been developed on the assumption that such a 2% Special Fund would continue to be administered by the NIB but its future contribution rate allocation has been assumed to be set equal to the present level of payments made out of the 2% Special Fund to the Government, i.e. at 0.8 per cent of insurable earnings.

The ILO recommends the introduction of an automatic mechanism of adjustment subject to a cap of the ceiling on insurable earnings, of fixed benefit amounts and of pensions in payment in line with
wage developments. A wage reference basis for indexation would allow the parallel development of standards of living between the active insured persons and pensioners. A mechanism for automatic indexation should however have a control not to allow an unlimited financial commitment on the part of the NIB, e.g. by way of introducing a maximum rate of increase. It is also recommended that the current pensions in payment be adjusted on an individual basis to compensate for past price inflation since the time of individual entries into retirement.